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## Agenda Item 6

April 11, 2011

### TO: MEMBERS OF THE INVESTMENT POLICY SUBCOMMITTEE

- I. **SUBJECT:** Repeal of the Policy for Directed Brokerage Arrangement
- II. **PROGRAM:** Total Fund
- III. **RECOMMENDATION:** Recommend to the Investment Committee to Repeal the Statement of Investment Policy for Directed Brokerage Arrangement

#### IV. ANALYSIS:

The Statement of Investment Policy for Directed Brokerage Arrangement (Policy) was designed to provide guidance regarding the collection and use of funds related to the recapture of commissions paid by CalPERS to brokers. The Policy outlines specific guidelines related to the arrangements that maximized funds available for investment research, analysis, analytical tools and transaction services.

Since its inception in 2002, the Policy has decreased in utilization and become less cost effective. Over the last five years alone, the funding made available for research and analysis through these arrangements has decreased by 77.4%. Additionally, the program's internal management involves efforts from 15 staff from the Fiscal Services Division and the Investment Office (INVO).

Most importantly, over the last few years the industry best practice has been to completely eliminate these types of arrangements. In an effort to align with best practices, increase transparency in expenditures, and improve cost effectiveness, INVO recommends that the Policy be repealed as of June 30, 2011, with a sunset date of September 30, 2011.

With the repeal of the Policy, current expenditures funded from these arrangements, at an annual cost of \$1.4MM would be funded from the Investment Expense budget in Fiscal Year 2011-12. Removal of the Policy would further reduce the complexity of financial expense tracking and reporting, by moving from three funding sources to two (Administrative Accounting and Investment Expense). Quarterly Investment Expense projection and expenditure reports will continue to be provided to the Committee and will reflect the transfer of expenditures.

From the time of Policy repeal to the sunset date, participating external managers and brokers will be notified and corresponding contracts will be amended. As has always been the practice, internal staff and external managers will continue the use of those brokers that satisfy due diligence and best execution requirements.

The Office of Enterprise Compliance and the Legal Office participated in the review of this item.

## **V. STRATEGIC PLAN:**

Repealing the Policy would uphold the following CalPERS strategic goals:

I. Exercise global leadership to ensure the sustainability of CalPERS pension and health benefit systems.

IX. Achieve long-term, sustainable, risk adjusted returns.

## **VI. RESULTS/COSTS:**

Repeal of the Policy is not anticipated to have any associated staff costs. Expenditures related to this arrangement will remain the same, with funding to be allocated from Investment Expense. Additionally, Staff believes repealing this Policy would generate a savings in commission rates and increase staff efficiency towards other critical workload.

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